

Message Text

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ACTION ARA-20

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-07 H-03 INR-10 L-03

NSAE-00 NSC-10 PA-03 RSC-01 PRS-01 SPC-03 SS-15

USIA-15 ACDA-19 IO-15 AID-20 COME-00 EB-11 FRB-02

TRSE-00 XMB-07 OPIC-12 CIEP-02 LAB-06 SIL-01 OMB-01

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FM AMEMBASSY SANTIAGO

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INFO AMEMBASSY ASUNCION

AMEMBASSY BOGOTA

AMEMBASSY BRASILIA

AMEMBASSY BUENOS AIRES

AMEMBASSY CARACAS

AMEMBASSY LA PAZ

AMEMBASSY LIMA

AMEMBASSY MONTEVIDEO

AMEMBASSY QUITO

AMEMBASSY RIO DE JANEIRO

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C O N F I D E N T I A L SECTION 1 OF 2 SANTIAGO 4862

DEPT PLEASE PASS OTHER INTERESTED POSTS

EO 11652: GDS

TAGS: ECON, CI

SUBJECT: CHILE'S NEW ECONOMIC POLICIES

1. SUMMARY: A GROUP OF YOUNG ORTHODOX ECONOMISTS, MOSTLY TRAINED AT THE UNIVERSITY OF CHICAGO, ARE TRYING TO CONVINCE CHILE'S MILITARY GOVERNMENT TO ADOPT A PACKAGE OF MEASURES DESIGNED TO ACCELERATE THE COUNTRY'S ECONOMIC GROWTH THROUGH USE OF FREE MARKET FORCES, RATIONAL MONETARY AND FISCAL POLICIES, CONFIDENTIAL

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ECONOMIC DECENTRALIZATION AND THE PROMOTION OF DOMESTIC AND FOREIGN INVESTMENT. THE PLAN WAS DRAWN UP BEFORE SEPT 11 AND HAS THE ADVANTAGE OF BEING THE ONLY COMPREHENSIVE SET OF POLICIES PRESENTLY BEFORE THE MILITARY. MOST OF THESE TECHNOCRATS

ARE NOW IN INFLUENTIAL ADVISORY POSTS. THE SIGNIFICANT NUMBER OF GOC POLICIES ANNOUNCED TO DATE CLEARLY SHOW THEIR INFLUENCE. THE YOUNG ECONOMISTS NOT ONLY HAVE JOB OF CONVINCING MILITARY THEIR IDEAS ARE MORE VALID THAN OTHERS BEING PRESENTED, BUT THEY MUST ALSO KEEP THE GOVERNMENT COMMITTED TO THOSE IDEAS THROUGH THE TIME NECESSARY FOR DESIRED RESULTS TO DEVELOP. THIS REGIME SO FAR DOES NOT SEEM ADVERSE TO PRESCRIBING BITTER MEDICINE FOR WHAT IT CONSIDERS SERIOUS AILMENTS. END SUMMARY

THE PROGRAM

2. A GROUP OF ABOUT 14 YOUNG CHILEAN ECONOMISTS (MOSTLY BETWEEN 30-40 YEARS OLD) PREPARED 284-PAGE DOCUMENT PRIOR TO COUP OUTLINING MEASURES WHICH THEY CONSIDERED NECESSARY FOR ANY SUCCESSOR GOVT TO TAKE IF CHILE WAS TO RECOVER ECONOMICALLY. THEIR PLAN WAS NOT AIMED AT TURNING CLOCK BACK ON ALL WHICH OCCURRED DURING ALLENDE REGIME. THEIR IDEAS DIFFERED IN SOME IMPORTANT ASPECTS FROM POLICIES FOLLOWED BY FREI AND PREVIOUS GOVTS. ESSENTIAL POINTS OF PROGRAM ARE ESTABLISHMENT OF MARKET ECONOMY WITH RESOURCES ALLOCATED BY PRICES, DECENTRALIZATION OF PUBLIC SECTOR ENTERPRISES AND REDUCTION OF ROLE OF CENTRAL GOVT MAINLY TO INDICATIVE PLANNING AND REMOVAL OF OBSTACLES TO GROWTH. OBJECTIVES OF PROGRAM ARE HIGH GROWTH RATE, INDIVIDUAL LIBERTY, ECONOMIC STABILITY (IN POSITIVE SENSE), AND SOCIAL JUSTICE.

3. YOUNG TECHNOCRATS CONSIDER BASIC TOOLS FOR RESTRUCTURING ECONOMY WOULD BE:

A. CHANGING RELATIVE PRICES OF IMPORTED VERSUS LOCALLY PRODUCED GOODS BY LARGE DEVALUATION OF EXCHANGE RATE AND REDUCTION OF TARIFFS. PRODUCING IN MINING, AGRICULTURE, ETC., IN WHICH CHILE HAS NATURAL ADVANTAGE, WOULD BE ENCOURAGED BY RAISING PRODUCER INCOME. INDUSTRIES WOULD GET LESS PROTECTION (30 PC AVERAGE TARIFF WAS MENTIONED) AND WOULD BE FORCED TO IMPROVE PRODUCTIVITY OR DISAPPEAR. SHORT-TERM CAPITAL CONTROL WOULD BE USED TO PREVENT CAPITAL FLIGHT.
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B. GOVERNMENT DEFICITS AND INFLATION WOULD BE BROUGHT UNDER CONTROL PRINCIPALLY BY REQUIRING PUBLIC SECTOR ENTERPRISES TO BE SELF-FINANCING. SOME SUBSIDIES FOR BASIC NECESSITIES, PARTICULARLY FOR LOW-INCOME GROUPS, WOULD BE MAINTAINED TEMPORARILY.

C. THE REAL INCOME OF ALL CHILEANS WOULD BE REDUCED DURING AN INITIAL PERIOD. AS ECONOMY GROWS FURTHER INCOME DISTRIBUTION COULD OCCUR THROUGH PROGRESSIVE TAXATION AND SELECTED EXPENDITURES BY CENTRAL GOVERNMENT.

4. OTHER RECOMMENDATIONS OF THE TECHNICIANS, WHICH THEY STRESS ARE INTEGRAL PARTS OF A PLAN WHICH MUST BE ADOPTED IN

ITS ENTIRETY, ARE AS FOLLOWS: DOMESTIC SAVINGS AND INVESTMENT WOULD BE ENCOURAGED THROUGH POSITIVE INTEREST RATE; PRIVATE FOREIGN INVESTMENT (WITH SAFEGUARDS) WOULD BE ENCOURAGED, PARTICULARLY IN EXPORT AND IMPORT SUBSTITUTION ACTIVITIES; FOREIGN DEBT WOULD BE RESCHEDULED AND RATIONALIZED; TAX SYSTEM WOULD BE CONVERTED FROM HEAVY RELIANCE ON SALES TAXES TO VALUE ADDED TAX; HEAVY TAXES WOULD BE PLACED ON LUXURY GOODS CONSUMPTION, WHICH OF LOCAL OR IMPORTED ORIGIN; INITIAL IMPACT OF ABOVE MEASURES ON EMPLOYMENT WOULD BE SOFTENED BY UNEMPLOYMENT INSURANCE AND PUBLIC WORKS PROJECTS; EFFICIENT CAPITAL MARKET WOULD BE ESTABLISHED TO ELIMINATE DISCRIMINATION IN CREDIT POLICIES; AND SOCIAL SECURITY SYSTEM WOULD BE REVAMPED TO REDUCE COST OF LABOR RELATIVE TO COST OF CAPITAL.

THE TECHNOCRATS

5. THE AUTHORS OF ABOVE PROGRAM ARE: EMILION SANFUENTES, ANDRES SANFUENTES, MANUEL CRUSAT, PABLO BARAONA, SERGIO DE CASTRO, ALVARO BARDON, SERGIO UNDURRAGA, JUAN VILLARZU, JOSE LUIZ ZAVALA, JUAN BRAUN, JUAN CARLOS MENDEZ, ENRIQUE TASSANA, TOMAS LACKINGTON, AND CAMILION CARRASCO. ALMOST ALL ARE UNDER 40 AND 9 OF THEM ATTENDED UNIVERSITY OF CHICAGO. BEFORE COUP NEARLY ALL WERE PROFESSORS AT UNIVERSITY OF CHILE OR CATHOLIC UNIVERSITY. MOST WERE ALSO WELL AND FAVORABLY KNOWN TO EMBASSY. THE MAJORITY NOW OCCUPY IMPORTANT ADVISORY POSITIONS IN MILITARY GOVERNMENT. FOR EXAMPLE, SERGIO DE CASTRO IS PRINCIPAL ADVISOR TO MINISTER OF ECONOMY; EMILIO SANFUENTES IS PRINCIPAL ADVISOR
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TO DIRECTOR TO ODEPLAN; AND JUAN VILLARZU IS NEW DIRECTOR OF BUDGET OFFICE IN MINISTRY FINANCE. ALVARO BARDON AND PABLO BARAONA, ALTHOUGH THEY HAVE NOT YET ACCEPTED GOVERNMENT JOBS, ARE INFLUENTIAL UNOFFICIAL ADVISORS. FOUR OF THE TECHNOCRATS ARE NOW WORKING IN CENTRAL BANK. MOST OF THE TECHNOCRATS ARE AFFILIATED WITH PDC OR ARE INDEPENDENTS. PABLO BARAONA IS MOST IMPORTANT PN SUPPORTER.

6. THE GROUP IS TRYING TO USE ITS INITIAL ADVANTAGE IN PROGRAM AND ORGANIZATION TO PUSH THROUGH THE MAJOR POINTS OF ITS PROPOSAL QUICKLY. THEY FEAR THAT DELAY WILL FAVOR OTHER IDEAS (SUCH AS TRADITIONAL CHILEAN INDUSTRIALISTS WHO WANT HIGH TARIFFS AND RETURN TO PRE-ALLENDE RULES OF GAME) OR OTHER INDIVIDUALS WHOM THEY DISTRUST. MOST IMPORTANT IN LATTER CATEGORY IS RAUL SAEZ, RECENTLY RETURNED TO CHILE, WHO MANY ARE CURRENTLY SAYING IS GENERAL LEIGH'S CANDIDATE FOR "ECONOMIC CZAR". TECHNOCRATS CLAIM SAEZ IS VERY CONSERVATIVE IN VIEW, IS CONNECTED TO TRADITIONAL INDUSTRIALISTS, AND UNABLE TO WORK WITH A STAFF OR ACCEPT IDEAS OF OTHERS. THEY WOULD LIKE TO ISOLATE SAEZ, BUT ARE BEING VERY CAREFUL TO AVOID OPEN CONFRONTATION. AS CONTRAST TO ATTITUDE TOWARD SAEZ, TECHNOCRATS ARE WORKING CLOSELY WITH ORLANDO SAENZ AND RICARDO CLARO. TECHNOCRATS SAY THEY SEEK NO POWER FOR THEMSELVES, BUT THEY FEEL SELECTION OF SOUND ECONOMIC ADVISORS

BY INEXPERIENCED MILITARY GOVERNMENT IS OF SUCH IMPORTANCE
THAT THEY MUST MAKE SURE THAT GOOD PEOPLE ARE CHOSEN.

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C O N F I D E N T I A L SECTION 2 OF 2 SANTIAGO 4862

GOC ACTIONS AND POLICIES

7. CONSIDERING ECONOMIC CHAOS WHICH MILITARY INHERITED AND
THEIR OWN LACK OF EXPERIENCE IN THIS AREA, THEY HAVE DECIDED
ON MANY IMPORTANT BASIC POLICIES IN A RELATIVELY SHORT TIME.
MINECON GONZALEZ HAS TALKED IN TERMS OF THREE-STAGE PROGRAM:
(1) ELIMINATE BLACK MARKET AND QUEUES BY RESTORING NORMAL
DISTRIBUTION, WHILE ADJUSTING PRICES TO MORE REALISTIC LEVELS;
(2) FURTHER PRICE ADJUSTMENTS WILL BE MADE OVER TIME TO
ENCOURAGE PRODUCTION OF SELECTED GOODS, AND PRICES IN NEARLY
ALL CASES WILL AT LEAST COVER COST OF PRODUCTION; (3) PUBLIC
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FINANCES WILL BE PUT IN ORDER, INCOME POLICY DEVISED AND

ADJUSTMENTS MADE IN FOREIGN EXCHANGE RATES.

8. THE MOST IMPORTANT ECONOMIC STEP GOC HAS TAKEN TO DATE WAS DEVALUATION OF OCT 1. FX RATE STRUCTURE WAS SIMPLIFIED AND RATES MOVED TO MORE REALISTIC LEVEL. THIS IS SENDING TREMENDOUS SHOCK THROUGH ENTIRE ECONOMY (SANTIAGO 4760) AND WILL CHANGE BROAD RANGE OF RELATIVE PRICES. GOC HAS ANNOUNCED THAT NO "MONETARY REFORM" (SUCH AS NEW CURRENCY OR DROPPING ZEROS FROM PRESENT SYSTEM) IS PLANNED. IT SAYS FUTURE ADJUSTMENTS IN EXCHANGES RATES WILL BE MADE AS NEEDED TO KEEP RELATIVE PRICES IN BALANCE.

9. OFFICIAL PRICES FOR MANY ITEMS, SUCH AS MEAT, HAVE BEEN INCREASED GREATLY TO ABOUT PRE-COUP BLACK MARKET LEVEL. A FEW FREE MARKET PRICES HAVE DECLINED. MINECON HAS SAID MOST PRICE CONTROLS WILL BE LIFTED (ALTHOUGH THIS NOT YET DONE) AND OFFICIAL PRICES RESTRICTED MAINLY TO GOODS AND SERVICES FOR WHICH THERE IS NO FREE MARKET. GOVERNMENT IS AWARE THAT ABOVE POLICIES PLUS EFFECTS OF DEVALUATION ON IMPORTED CONSUMER GOODS AND RAW MATERIALS WILL RESULT IN LARGE INFLATION DURING NEXT FEW MONTHS. THEY HOPE TO TAKE ADVANTAGE OF PRESENT (ALTHOUGH PROBABLY TEMPORARY) PRECIPITOUS DROP IN VELOCITY OF CIRCULATION OF MONEY TO SOFTEN INFLATIONARY IMPACT. GOC SAYS EXPANSION OF MONEY SUPPLY HAS ALSO BEEN SLOWED.

10. MEANWHILE, GOC HAS ANNOUNCED THAT GENERAL WAGE READJUSTMENT SCHEDULED BY LAW FOR OCT 1, 1973, WILL NOT BE GIVEN. IT SAYS SOME TYPE OF COST OF LIVING BONUS WILL BE GIVEN THROUGH REMAINDER 1973 TO OFFSET RISING PRICES WHILE GOVERNMENT STUDIES LONGER TERM POLICY. NO DETAILS OF BONUS PLAN HAVE BEEN GIVEN, BUT LOWER INCOME GROUPS HAVE BEEN ASSURED THEY WILL NOT BE CALLED UPON TO BEAR ENTIRE BURDEN. RATHER, ALL CHILEANS RE BEING TOLD THEY MUST TIGHTEN BELTS. SINCE PRINCIPAL LABOR CONFEDERATION HAS BEEN ABOLISHED, AND COLLECTIVE BARGAINING AND RIGHT TO STRIKE SUSPENDED, MAJOR MEANS WHICH THOSE WHO MIGHT OPPOSE INCOMES POLICIES CAN USE TO PROTEST HAVE BEEN ELIMINATED.

11. THE JUNTA HAS GONE ON RECORD AS FAVORING PRIVATE FOREIGN INVESTMENT AND WILLING TO SEEK SOLUTION TO COPPER COMPENSATION
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PROBLEM. AN INVESTMENT LAW REPORTEDLY IS NOW BEING DRAFTED. MANY FIRMS SEIZED BY ALLENDE GOVERNMENT HAVE BEEN RETURNED TO FORMER MANAGERS. AS GENERAL POLICY, JUNTA HAS DECIDED THAT THOSE FIRMS LEGALLY IN PUBLIC SECTOR WILL REMAIN THERE AND THOSE IN PRIVATE SECTOR WILL REMAIN UNTOUCHED. MORE DIFFICULT AREA INVOLVES BUSINESSES "LEGALLY" INTERVENED OR REQUISITIONED BY UP. THESE EVIDENTLY WILL BE DEALT WITH ON CASE-BY-CASE BASIS. GOC FAVORS INCREASED PARTICIPATION BY WORKERS IN MANAGEMENT DECISIONS AND PROFITS, REGARDLESS OF TYPE OF OWNERSHIP. IN AGRICULTURE, GOVERNMENT HAS DECIDED INDIVIDUAL

TITLES WILL BE GIVEN TO FARMERS WHO HAVE RECEIVED LAND UNDER AGRARIAN REFORM PROGRAM. PROPERTIES LEGALLY EXPROPRIATED WILL NOT BE RETURNED, BUT THOSE ILLEGALLY SEIZED WILL BE. NO FUTURE EXPROPRIATION WILL BE MADE OF FARMS BELOW 40 BASIC HECTARES.

12. ONE OF THE GOVERNMENT'S EARLY ACTS WAS A PLEDGE TO HONOR ITS INTERNATIONAL FINANCIAL OBLIGATIONS. CENTRAL BANK IS STILL TRYING TO UNTANGLE CHILE'S FOREIGN ACCOUNTS. AN IMF MISSION APPARENTLY IS BEING SCHEDULED FOR NOVEMBER AND A PARIS CLUB SESSION LOOKS POSSIBLE IN JANUARY. MEANWHILE, CHILEANS ARE TALKING WITH US BANKS, USG, AND OTHER POTENTIAL CREDITORS. SEVERAL BANKS HAVE ALREADY MADE FRESH COMMITMENTS. PRELIMINARY STEPS TO RE-ESTABLISH CHILE'S CREDITWORTHINESS WITH THE WORLD BANK, IDB, AND OTHER LENDERS HAVE BEEN TAKEN. CHILEANS STILL HAVE QUITE A LOT OF HOMEWORK TO DO BEFORE THEY WILL BE ABLE TO COME UP WITH ACCURATE FIGURES ON THE TYPE AND AMOUNTS OF ASSISTANCE COUNTRY WILL NEED DURING THE NEXT FEW YEARS.

13. COMMENT: TECHNOCRAT PROGRAM CAN SOLVE CHILE'S BASIC ECONOMIC PROBLEMS IF GIVEN TIME TO WORK. IT APPEARS TO CONTAIN ELEMENTS NEEDED FOR IMF STANDBY ONCE SOME NUMBERS ARE ADDED. THE PROBLEM WITH PROPOSED POLICES IS THAT SEVERAL YEARS MAY BE NEEDED BEFORE BENEFITS BECOME OBVIOUS TO POORER HALF OF CHILE'S POPULATION. SHOULD GOC BY DESIGN OR ACCIDENT SQUEEZE THIS GROUP, FROM WHICH ALLENDE SUPPORT CAME, TOO MUCH, THEIR PROTESTS WILL BE FELT EVEN IF TRADITIONAL CHANNELS (SUCH AS LABOR UNIONS) ARE CLOSED. THE TECHNOCRATS ARE GENERALLY AWARE OF THIS AND ARE CASTING ABOUT FOR A POLITICALLY REALISTIC INCOMES POLICY WHICH WILL STILL HAVE DESIRED ECONOMIC
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CONSEQUENCES. IT IS A FINE LINE TO WALK. IN IMPLEMENTATION OF INCOMES POLICY TECHNICAL FINESSE COULD BE AS IMPORTANT AS POLITICAL WILL. IN ANY CASE, ANY SERIOUS ATTEMPT TO DEAL WITH ROOT CAUSES OF CHILE'S ECONOMIC PROBLEMS WILL REQUIRE A STRONG AND DETERMINED GOVERNMENT.
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